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February 5, 1997

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax as an organization described in sections 501(c)(3) and 501(c)(4) of the Internal Revenue Code.

You were incorporated as a not-for-profit corporation on [redacted] under the laws of the state of [redacted]. Your purposes, as stated in your amended articles of incorporation, are exclusively charitable, religious, educational, and scientific. Your specific purpose, as stated in your articles, is to promote baseball for youths eighteen years of age and younger.

Your application states that you will fulfill these purposes primarily by making grants and scholarships available to young athletes. In subsequent correspondence you stated that you were not awarding scholarships. While you have made certain statements as to the percentage of time spent on various baseball related activities, you have not provided any substantiation of these figures. You have submitted no evidence to indicate that you sponsor, coach, or manage any baseball teams or leagues, or that you maintain a baseball complex. You have not explained who carries out these activities, where they are performed, or when they are performed. Your financial statements and proposed budgets do not include any expenditures for these activities.

Your articles and your bylaws provide for two classes of membership, executive and general. Executive membership is for life and is limited to thirteen persons. Executive members select your directors. Directors have lifetime terms, although they may be removed by a majority vote of the executive membership. Officers are elected by the directors, and may be either executive or general members. As of January 14, [redacted] your executive members and board of directors included [redacted]

Members of the general public may join as general members upon approval by

[redacted]

your board and payment of $ annual dues. It is not clear whether you have any general members, as you have reported no income from membership dues.

You filed your application for exemption, Form 1023, on [redacted]. On page five of your application you requested that we consider your application for section 501(c)(3) status as of [redacted]. You requested that we consider recognition of section 501(c)(4) status for the period prior to [redacted]. You also requested classification as a publicly supported organization under section 509(a)(2).

Financial information submitted with your application indicates that your sole source of income will be the operation of bingo games. You have stated that "all bingo games are administered solely with volunteered help." With your application, you included a list of [redacted] organizations or funds to which you made contributions in [redacted]. Only two of the [redacted] appear to be organizations described in section 501(c)(3) of the Code. You have provided no evidence to demonstrate that you in any way controlled the use of funds donated to non-501(c)(3) organizations, or that you verified that funds were used only for exempt purposes.

In [redacted], the [redacted] Department of State Revenue investigated your operations, terminated your bingo license, and imposed fines and penalties. On [redacted] upheld the decision of the Department of State Revenue (with one exception not here relevant). In [redacted] Court in all respects. The [redacted] findings included the facts outlined below.

There are [redacted] for-profit companies located at your address. Each of these companies is owned by one of your officers or members. These companies are [redacted]. In [redacted] and [redacted] you provided space and utilities to these companies at no charge. You paid substantial sums of money to each, totaling $[redacted] in [redacted] and $[redacted] in [redacted].

On [redacted], you purchased the property known as [redacted] and the inventory of [redacted] for $[redacted]. This transaction was financed by a promissory note. The purchase agreement included the assumption of certain liabilities to [redacted]. for the inventory of [redacted], the assumption of obligations of the seller to [redacted]., and assumption of a mortgage obligation of $[redacted]. On [redacted], all interest in the personal

[redacted]

property, equipment, and inventory of [redacted] (subject to the existing obligations to [redacted]) was transferred by you to [redacted] The officers of [redacted] are also your officers. You also loaned $[redacted] to [redacted], only $[redacted] of which has been repaid.

Each of the [redacted] companies named above issued checks to your bingo workers, and most of the bingo workers were paid by several companies simultaneously or successively. Your bingo workers picked up their paychecks from you once each week, regardless of which company issued the check. The [redacted] found, and the [redacted] affirmed, that you were not an [redacted]

I. Exempt Status under Section 501(c)(3)

Section 501(c)(3) of the Internal Revenue Code describes, in relevant part, corporations organized and operated exclusively for charitable and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides an organization is not operated exclusively for exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words "private shareholder or individual" are defined in Section 1.501(a)-1(c) of the regulations, which provides that these words refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the

[redacted]

creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513. In determining the existence or nonexistence of such primary purpose, all the circumstances must be considered, including the size and extent of the trade or business and the size and extent of the activities which are in furtherance of one or more exempt purposes. An organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business is not exempt under section 501(c)(3)

Section 513(f) of the Code provides that the term "unrelated trade or business" does not include any trade or business which consists of conducting bingo games. Bingo games are those games in which the wagers are placed, the winners are determined, and the distribution of prizes or other property is made in the presence of all persons placing wagers in such game. The conduct of such games cannot be an activity ordinarily carried out on a commercial basis, and the conduct of the games may not violate any State or local law. House Report No. 95-1608 2nd Session, 1978-2 C.B. 395 (397) states in pertinent part:

> The Committee does not intend that the carrying on of bingo games should be treated as an exempt function of a . . . tax exempt organization except to the extent it would be considered as an exempt function under present law. Also, the committee does not intend to revise the rules of present law which indicate that if conducting bingo is a primary activity of an organization, the organization may not qualify for tax exemption.

Rev. Rul. 64-182, 1964-1 C.B. 186 provides that a commercial organization will satisfy the primary purposes test of section 1.501(c)(3)-1(e) of the regulations and be entitled to exemption from federal income taxation as an organization organized and operated exclusively for charitable purposes where it is shown to be carrying on a charitable program commensurate in scope with its resources.

In Rev. Rul. 67-5, 1967-1 C.B. 123, the Service held that a foundation controlled by the creator's family was operated to enable the creator and his family to engage in financial activities that were beneficial to them, but detrimental to the foundation. This resulted in the foundation's ownership of non-income producing

[redacted]

assets which prevented its carrying on a charitable program commensurate in scope with its financial resources. The ruling concluded that the foundation was operated for a substantial non-exempt purpose and served the private interests of its creator and his family and therefore was not entitled to exemption under section 501(c)(3) of the Code.

Rev. Rul. 68-489, 1968-2 C.B. 210, describes an organization that distributes funds to nonexempt organizations. The exempt organization ensured use of the funds for section 501(c)(3) purposes by limiting distributions to specific projects that are in furtherance of its own exempt purposes. It retains control and discretion as to the use of the funds and maintains records establishing that the funds were used for section 501(c)(3) purposes. The Service concludes that the organization's exemption under section 501(c)(3) of the Code will not be in jeopardy even though it distributes funds to nonexempt organizations, provided it retains control and discretion over use of the funds for section 501(c)(3) purposes.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

Harding Hospital, Inc. v. United States, 505 F2d 1068 (1974) holds that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In est of Hawaii v. Commissioner, 71 T.C. 1067 (1979), aff'd without opinion, 647 F.2d 170 (9th Cir. 1981), the Tax Court concluded that an organization created to disseminate educational programs, the rights to which were owned by for-profit corporations, furthered the commercial, private purposes of the for-profit entities and did not qualify for exemption under section 501(c)(3) of the Code. The organization used the franchisor's methods, employees, and materials and paid royalties for the right to use the franchisor's programs. The organization argued that because the for-profit corporations were unrelated and the royalties were reasonable compensation for the use of the programs, no private benefit existed. The court rejected this argument:

> To accede to petitioner's claim that it has no connection with International [the franchisor] is to ignore reality. While it may be true that they are not formally controlled by the same individuals, International exerts considerable control over petitioner's activities. ... [P]etitioner's only function is to present to the public for a fee ideas

[redacted]

that are owned by International with materials and trainers that are supplied and controlled by EST, Inc. ... Moreover, we note that petitioner's rights vis-a-vis [the for-profit entities] are dependent on the existence of its tax-exempt status - an element that indicates the possibility of, if not likelihood, that the for-profit corporations were trading on such status. ...

Nor can we agree with petitioner that the critical inquiry is whether the payments made to International were reasonable or excessive. Regardless of whether the payments made by petitioner to International were excessive, [footnote omitted] International and EST, Inc. benefitted substantially from the operation of petitioner. ...

71 T.C. at 1080-81.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36, the Tax Court considered the qualification for exemption under section 501(c)(3) of the Code of a non-profit corporation that conducted continuing medical educational tours. The petitioner shared offices with a for-profit travel agency which was controlled by the petitioner's principal officer. Although the Foundation had two of three directors with no apparent connection to the travel agency, the owner of the travel agency had control of the daily operations of the Foundation. The Foundation used this travel agency exclusively for all travel arrangements. The Court found that a substantial purpose of the petitioner was benefitting the for-profit travel agency. It concluded that "when a for-profit organization benefits substantially from the manner in which the activities of a related organization are carried on, the latter organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes."

In Help the Children v. Commissioner, 28 T.C. 1128 (1957), the court held that an organization engaged in fundraising activities through the operation of bingo games, whose actual charitable functions consisted of contributions to charitable institutions of insubstantial amounts when compared to its gross receipts from the operation of the bingo games, does not qualify for exemption under section 501(c)(3) of the Code. See also, Piety, Inc. v. Commissioner, 82 T.C. 193 (1984) and P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984).

In Church by Mail, Inc. v. Comm., 765 F.2d 1387, the Court of Appeals for the 9th Circuit considered the qualification for exemption under section 501(c)(3) of an organization closely related to a for-profit corporation. In that case, an advertising agency owned by the individuals who controlled the church provided

[redacted]

the printing and mailing services for the Church's mass mailings. The Court concluded that the Church was operated for the substantial non-exempt purpose of providing a market for the advertising agency's services. The majority of the Church's income was paid to the advertising agency, and the available evidence supported an inference that the Church provided the primary market for the advertising agency's services. The Court further stated that "the critical inquiry is not whether particular contractual payments to a related for-profit corporation are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

The conduct of bingo games and similar activities on a regular basis is not, in itself, an activity that furthers exempt purposes under section 501(c)(3) of the Code. An organization may, however, be exempt under section 501(c)(3) where its sole source of support is from gaming activities, if it accomplishes exclusively charitable purposes by raising funds through such gaming and contributing funds derived therefrom to support charitable organizations. This form of indirect support of charity is itself a charitable activity justifying exemption under section 501(c)(3) if it is commensurate in scope with the organization's resources. See Rev. Rul. 64-182.

According to the information submitted with your application, your gross receipts in [redacted] were $[redacted]. Payments to other organizations were at most $[redacted], or approximately [redacted]% of your gross receipts. Furthermore, you distributed funds to organizations that are not exempt under section 501(c)(3) of the Code and you failed to exercise expenditure responsibility over these funds. See Rev. Rul. 68-489. As in the case of Help the Children v. Comm., you have not demonstrated that you carry on a substantial charitable program commensurate with your financial resources.

Furthermore, it is apparent that you have a substantial non-exempt purposes of benefitting for-profit companies owned by persons associated with you. You have made substantial payments to these companies. These payments served no exempt purpose. Rather, most of them were used to [redacted]. Furthermore, you provided these companies with space at no cost to them for rent, utilities, or maintenance. As in the cases of est of Hawaii, International Postgraduate Medical Foundation, and Church by Mail, these for-profit companies benefitted substantially from your activities. This is impermissible private benefit, and to the degree these companies are controlled by your officers or executive members, inurement as well.

[redacted]

Based on the extent of your gaming activities and the income from them, and your lack of a substantial charitable program, we have concluded that you engaged in gaming activities primarily for the purpose of furthering the private business interests of your executive members and directors.

II. Status as a Publicly Supported Organization

Section 509(a) of the Code provides that the term "private foundation" means an organization described in section 501(c)(3) other than certain organizations described in section 509(a)(1), (2), (3), or (4).

Section 509(a)(2) of the Code states, in part, that an organization will not be considered to be a private foundation if it normally receives more than one-third of its support from, among other things, gross receipts from performance of services related to its exempt function, and less than one-third of its support from investment income and unrelated business income.

Section 513(a)(1) of the Code excludes from the definition of unrelated business income income from a business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

As noted above, section 513(f) of the Code excludes income from bingo games from the definition of unrelated business income if certain requirements are met. The conduct of such games cannot be an activity ordinarily carried out on a commercial basis, and the conduct of the games may not violate any State or local law.

Section 1.513-5(d) of the regulations more specifically defines bingo as a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game.

In Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner, 70 TCM 673, the Tax Court held that the sale of "instant bingo" tickets resulted in unrelated business income. These tickets were preprinted with bingo card patterns and then covered with pull-tabs. Individuals purchased the tickets, pulled back the sealed tabs on the front of the card, and then compared the patterns under the tabs with the winning patterns printed on the back of the card. The court concluded that this game was not "bingo" as that term is defined in section 513(f) of the Code and

[redacted]

that income from the sale of instant bingo tickets was taxable. This decision was upheld by the United States Court of Appeals for the Fifth Circuit in Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner, 98 F.3d 190.

Your sole sources of income were from bingo and the sale of pull-tabs. The income from your bingo games does not fall within the exception of section 513(f) because your bingo games were not conducted in compliance with State law. Such income is therefore unrelated business income.

Your pull tab sales are not bingo games within the meaning of the Code and regulations cited above. See Julius M. Israel Lodge of B'nai B'rith No. 2113 v. Commissioner. Income from those sales could be excluded from unrelated business income only if substantially all the work in selling the pull-tabs was performed for you without compensation. Since your employees were in fact compensated, the income from pull-tab sales is likewise unrelated business income.

Since your sole source of income was income from an unrelated trade or business, you would be classified as a private foundation if you qualified for exemption under section 501(c)(3) of the Code.

III. Exempt Status under Section 501(c)(4) of the Code

Section 501(c)(4) of the Code describes, in relevant part, civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(1) of the regulations provides that an organization may be exempt as an organization described in section 501(c)(4) if it is not organized or operated for profit and it is operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2) of the regulations provides, in relevant part, that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. An organization is not operated primarily for the promotion of social welfare if its primary activity carrying on a business with the general public in a manner similar to organizations which are operated for profit.

[redacted]

In Commissioner v. Lake Forest, Inc., 305 F.2d 814 (4th Cir. 1962), the Fourth Circuit Court of Appeals held that an organization providing housing on a cooperative basis did not exclusively promote social welfare as defined in section 501(c)(4) because it benefited a private group of individuals, not the community as whole.

In Contracting Plumbers Cooperative Restoration Corp. v. United States, 488 F.2d 684 (2d Cir. 1973), cert. denied, 419 U.S. 827, 685,687 (1974), the Court of Appeals held that an organization assisting member plumbers in their profession by repairing the cuts they made in city streets was not exempt under section 501(c)(4). The court concluded that the organization was not primarily devoted to the common good because it provided substantial benefits to its private members that were different than those benefits provided to the public. The grounds for this holding were 1) the plumbers' apparent business interest in forming the organization, 2) the mutual aid purpose of the organization indicated in its bylaws, 3) the substantial member benefits evidenced because the organization provided members better services at cheaper prices than would have been eventually charged by the city whole providing no services to nonmembers, and 4) the receipt by members of economic benefits precisely to the extent they used and paid for the organization's services.

Rev. Rul. 86-98, 1986-2 C.B. 74, holds that an individual practice association that provides health services through written agreements with health maintenance organizations does not qualify for exemption from tax as a social welfare organization under section 501(c)(4) of the Code. The main functions of M are to provide an available pool of physicians who will abide by its fee schedule when rendering medical services to the subscribers of an HMO, and to provide its members with access to a large group of patients, the HMO subscribers, who generally may not be referred to nonmember-physicians. M negotiates contracts on behalf of its members with various HMOs, administers the claims received from its members, and pays them according to its reimbursement agreement. These facts indicate that M is akin to a billing and collection service, and a collective bargaining representative negotiating on behalf of its member-physicians with HMOs. In addition, M does not provide to HMO patients access to medical care which would not have been available but for the establishment of M, nor does it provide such care at fees below what is customarily and reasonable charged by members in their private practices. Thus, M operates in a manner similar to organizations carried on for profit, and its primary beneficiaries are its member-physicians rather than the community as a whole.

The court cases and revenue rulings cited above demonstrate that mere organization on a non-profit basis is insufficient to establish exemption under

[redacted]

section 501(c)(4) of the Code. An organization seeking such status must demonstrate that it is primarily engaged in activities promoting social welfare rather than benefitting a limited number of persons in their individual capacities. Since you are engaged primarily in the conduct of bingo games, an activity which does not itself promote social welfare, you do not meet the requirements of section 501(c)(4) and the regulations thereunder. Furthermore, the primary beneficiaries of your activities are your members and the various businesses they control rather than the community as a whole. In this respect, you are similar to the organization described in Rev. Rul. 86-98.

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for recognition of exemption under section 501(c)(3) or section 501(c)(4) of the Code. Furthermore, even if you qualified for exemption under section 501(c)(3), you would be classified as a private foundation. Contributions to you are not deductible under section 170 and you are required to file federal income tax returns.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this proposed ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director. Thereafter, any questions about your federal income tax status should be addressed to that office. The appropriate State officials will be notified of this action in accordance with section 6104(c) of the Code.

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You will expedite our receipt of your reply by using the following address on the envelope:

Internal Revenue Service
CP:E:EO:T:4, Room 6236
1111 Constitution Avenue, NW
Washington, DC 20224

Sincerely yours,

Gerald V. Sack
Chief, Exempt Organizations
Technical Branch 4

cc: [redacted]